Quarterly Economic Commentary

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FRASER OF ALLANDER INSTITUTE

The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short term movements in economic activity. Along with the Quarterly Economic Commentary the Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium term and long term aspects of the Scottish economy. The Institute is a research unit in the Strathclyde Business School, a faculty of the University of Strathclyde.

Information for subscribers

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Notes to contributors

The editors welcome contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Editor.

Articles accepted for publication *must* be supplied on 3.5 inch or 5.25 inch disks in either WordPerfect or ASCII format.

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QUARTERLY ECONOMIC COMMENTARY

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OUTLOOK AND APPRAISAL

Both Scotland and the UK continue to bump along the bottom of the recession. Some recent UK data suggest the glimmerings of an upturn, but recovery is likely to be slow and lengthy.

Previous quarterly data up to the first quarter of 1991 had suggested that the rate of decline in UK GDP was steadily slowing. However, preliminary GDP figures for the second quarter indicate a fall of 0.9% compared with the first quarter, rather more than might have been expected if there was any clear sign of the recession bottoming out by the middle of the year. This suggests that the economy is continuing in the trough of the recession, and if these preliminary data are not substantially revised it is unlikely that there will be much of an upturn before 1992.

There may, however, be faint signs that the long-awaited revival in consumer spending is beginning to materialise. After falling in April and May seasonally-adjusted retail sales rose by 1.5% in June, and the July figure has been revised upwards from a 0.3% rise to an increase of 0.7%. Over the six months to July retail sales were 0.5% higher than the previous half-year. This has been accompanied by a net increase in outstanding consumer credit of £187 million in July, following a fall in May and a very slight rise in June. These figures exclude bank loans, and the recent half percentage point cut in interest rates may provide a further boost to credit card borrowing which forms much of the monthly fluctuations in the consumer credit figures. Certainly, these data tend to be very volatile, but an increase in retail sales fuelled by credit card debt rather than rising real incomes is not the kind of sustainable rise in consumer spending which the government hopes will drag us out of recession.

Scottish Performance

Provisional data for the Scottish index of production and construction for the first quarter of 1991 suggest some levelling off of the rate of decline following the precipitous fall recorded in the latter part of 1990. Depending on the extent of subsequent revisions, this suggests that Scottish industrial performance may be resuming its longer-term pattern in relation to the UK after the 'bump and slump' of late 1989 and 1990 (of which more later). According to the latest figures, output in the production and construction industries in Scotland declined by 1.0% over the four quarters to March 1991, compared with a fall of 1.4% for the UK as a whole. In manufacturing, the figures for the same period make less attractive reading; a decline of 3.4% in Scotland compared with 1.9% in the UK.

In the last Commentary it was suggested that the apparent sharp rise and subsequent slump in Scottish industrial output recorded in 1990 was due at least in part to overestimation of the rise in output for the first quarter of that year. Recent revisions to the data suggest that this was indeed the case, although the effect has been to reduce rather than eliminate the output blip. Official data published in May indicated a rise in manufacturing output of 5.0% in that single quarter; this has now been revised to 2.5%, which is still substantial but much less dramatic than was previously indicated. The slump in manufacturing output in the second half of 1990 relative to the first half has now been revised downwards from 9.8% to 7.8%, and later data revisions may further reduce the extent of the recorded fall.

In Scotland, 27% of industrial output is devoted to the production of investment goods compared with 19% in the UK as a whole, which makes the investment behaviour of British business of particular interest to Scotland. Here the outlook is far from rosy. Provisional estimates indicate that capital expenditure by UK manufacturing industry was 28% lower in the second quarter of this year than in the same period in 1990; in the engineering industry, crucial to Scotland's investment goods sector, the fall was 31%. Manufacturing investment has been in decline since the second quarter of last year, and survey evidence indicates that investment intentions remain weak.

Quite apart from the implications which this may have for productive capacity in the near future, it would be reasonable to expect such a slump in investment to have a (lagged) effect on the output of the investment goods sector in Scotland. In fact, the behaviour of this sector in 1990 does seem rather odd; output slumped by 17.8% in the second half of last year (revised from the 22% fall indicated in the last Commentary), at a time when manufacturing investment spending was only just beginning to show signs of faltering. Then in the first quarter of 1991, just as investment began to fall rapidly, the latest provisional figures indicate a jump of 8.6% in Scottish investment goods production. These figures do tend to be rather volatile, and so looking for a straightforward relationship with UK manufacturing investment may be rather ambitious; nevertheless, such a marked fall in investment spending does suggest future problems for an important sector of Scotland's economy.

In August unemployment rose for the tenth successive month in Scotland to stand at a seasonally-adjusted total of 228,500, 9.2% of the workforce. In each of these months the percentage increase in the number of people unemployed has been less in Scotland than in the UK as a whole, and in the year to August the number unemployed in Scotland rose by 14.0% compared with a rise of 46.6% for the UK. Of the UK regions, only Northern Ireland exhibited a lower overall rise than Scotland over this period. Further evidence that slackening in the labour market is occurring more slowly in Scotland is provided by the data on unfilled vacancies in jobcentres, which fell by 31% in the year to August compared with 35% for the UK. However, the number of unfilled vacancies is now rising in the UK which is not the case in Scotland.

Although there is no evidence that the rate of increase in unemployment is accelerating in Scotland (seasonally-adjusted unemployment in June, July and August rose by less than in any of the previous three months), there are clear signs of a narrowing in the differential between the monthly rates of increase in Scotland and the UK. Scottish unemployment began to rise in November 1990, and between then and March this year the monthly rate of increase in Scottish unemployment averaged 3.1 percentage points below that of the UK. Between April and August, however, this differential narrowed to an average of 1.2 percentage points. As unemployment continues to rise in both economies this differential could eventually disappear, but in order for the differential in Scotland's favour to be markedly reversed there would have to be clear evidence that Scotland will remain in recession for significantly longer than the UK, or recover significantly more slowly. At the moment this does not seem likely.

The Short-Term Outlook

As Scotland's economy is intimately linked to that of the rest of the UK it makes sense to begin by looking at the immediate outlook for the UK economy. The CSO's cyclical indicators, which attempt to show turning points around a long-term trend, hold out little hope of a speedy recovery. The coincident indicator for July, designed to show current turning points, is still in decline, although the rate of decline has slowed considerably since January. The longer leading index has a reasonable track record of indicating turning points one year in advance; it indicated such a turning point in May 1990, but then virtually stagnated until January this year before turning slowly upwards in February then stagnating again between March and July. Taken together, these indicators suggest a very weak recovery in the second half of this year, with real improvement in the economy delayed until 1992.

Until now, divining Scotland's likely future performance from these and other indicators has been hampered by the lack of a suitable model. However, this issue of the Commentary contains the first projections from the Institute's new short-term model of the Scottish economy, which is designed to provide forecasts of quarterly movements in the seasonally-adjusted Scottish output index for production industries. Details of the forecasts can be found at the beginning of the Scottish Economy section, and a description of the model is contained in the Briefing Paper in this issue.

The forecast indicates that a turning point will occur in the third quarter of this year in the production industries, but that output growth will remain hesitant in 1991 and throughout much of 1992. An output decline of 1.5% this year is followed by a modest 0.9% recovery in 1992, compared with an expected rise of 1.2% in UK production output. This is in line with the expectation that Scotland will resume economic growth no later than the UK, but having suffered a shallower (if not shorter) recession than the UK as a whole.

13 September 1991